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Travel in Alaska and Saudi Arabia

Preparing Federal Corporation Income Tax Returns

Relief Under Section 721

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Travel in Alaska and Saudi Arabia

BY JACK ROWSON

(San Francisco Office)

The U. S. Navy has a recruiting slogan "Join the Navy and see the World" which, judging from my experiences over the past year and one-half, could aptly be borrowed and changed to "Join L. R. B. & M. and see the World," as the following will demonstrate.

A good time to visit Alaska, so I am informed, is in the summer, and if one is going to Saudi Arabia the preferable season is winter. Unfortunately, however, public accounting assignments cannot always be suited to climatic conditions, so I had the pleasure of going to Anchorage, Alaska, in November, 1947 for seven weeks of refrigeration and, two years later, to Saudi Arabia on a superheated assignment extending from May 16 through July 31, 1949. Merely to bolster the claim to the above slogan, I might add that in the interim I was on engagements in various places from Los Angeles, California, to Spokane, Washington, and that during the time of my sojourn in Alaska another member of our staff was in Hawaii on an engagement.

In this modern age of air travel the problem of getting from here to there is a relatively minor one, but at the time of the Alaska trip my air experience was quite limited. On one trip from San Francisco to Portland, Oregon, the weather really closed in and the hostess advised us of our projected landings at several widely separated fields, none of which, however, proved correct, because we finally landed at McChord Field, a U. S. Army airport at Tacoma, Washington, a mere one hundred fifteen miles from Portland.

After this experience it did not come as a surprise that my flying luck should hold true to form on the flight to Anchorage, Alaska. The plane arrived over the town on time, the weather and the visibility all around the town were excellent, but there were clouds over the town just low enough to preclude the granting of permission to land. After cruising around for an hour on the off-chance that the clouds might lift sufficiently to permit a landing, we headed north to Fairbanks about two hundred miles away. Here, again, permission to land was withheld for approximately half an hour, the field having been cleared for a Flying Fortress which was having

a spot of trouble; it finally limped in and our DC-4 promptly followed. It was a little cool, about 20° below zero, but the mercury would dip considerably below this as winter closed in.

Hotel accommodations in Fairbanks were somewhat limited, and it fell to my lot to share a room with several G. I.'s who were billeted in a small private home owned by a very hospitable couple who had lived in Alaska for over thirty years. My principal recollection of the night in Fairbanks was the G. I. who awakened when you turned off his radio, gave a good imitation of a bear who was disturbed in the middle of his hibernation, turned on the radio, and promptly went back to sleep. Well, morning came around, as it has a habit of doing, and several cups of coffee supplied by our hospitable hosts compensated somewhat for the deficiency of sleep.

We finally arrived in Anchorage approximately twenty-four hours behind schedule after some high flying over the clouds. We flew quite close to Mt. McKinley and the view of its snow-packed peak and those of its sisters protruding way above the clouds was very impressive.

Anchorage has two airfields, and we landed on the longer runway of the Army's Elmendorf Field. Incidentally, Alaska lays claim to being more air-minded than any other area in the world, in point of air travel per capita of population, and judging from my observations of the travel to points both within and without Alaska, the claim is probably well merited. The paucity of railroads and paved highways and the discomforts of travel on the latter in the wintertime add greatly to the demand for travel by air.

I was agreeably surprised during my stay in Anchorage at the relative mildness of the weather. I had expected to encounter a great deal of the sub-zero variety, but there were very few days when the mercury dropped below the zero point. During one week the local newspaper headlined the heat wave which was currently being experienced, with temperatures reaching up to better than 40° above zero. Rating, as it did, the newspaper headlines, I concluded that this weather was similar to the usual San Francisco variety, "very unusual."

Before I pass from the ever popular subject of weather, I might add that the Anchorage Chamber of Commerce has some very interesting statistics to prove that the climate of the surrounding Matanuska Valley is more equable than certain sections of the continental United States, although it was oftentimes a source of disappointment to me that I had not looked quickly enough and daylight had passed me by. Per contra, new arrivals from the States in the sum-

mertime informed me the problem of persuading their children to go to bed in the bright sunlight of late evening presented its difficulties.

Some random impressions of Alaska and Anchorage:

Compared to Stateside (the local appellation for the continental U. S.), wages and cost of living were considerably higher, and my Scotch character received a severe jolt when I had to pay 50 cents for a shoeshine and 25 cents for a Stateside newspaper, to mention two minor items.

The large number of bars located in one city block adjacent to my hotel in Anchorage, most of which had retail liquor stores in connection, and all of them seemed to be doing a thriving business.

The lack of schools or the excess of children, depending on the point of view, necessitating the use of some schools in two shifts, from 8 A.M. to 12 noon and 1 P.M. to 5 P.M.

The poor condition of the roads, over which one got a much smoother ride in the winter when the holes were filled with water and the latter became frozen.

The anomaly of apparent prosperity in the town, contrasted with the lack of funds in the City Treasury.

The young ladies in the office who came to work in parkas and mukluks, doffed their parkas but not their mukluks, and sounded like felines padding around.

Well, so much for Alaska and its mukluks, parkas, and fur-lined clothing; let's take a transfer and see what the other side of the world has to offer.

One day last spring Messrs. Breslin and Giles called me in for a talk and my bump of curiosity was aroused to a high pitch by such attention from two of the partners. I had already taken a seat, so the leading question put to me with little or no preamble by Mr. Giles did not literally knock me off my feet, but figuratively it did. How would I like to go to Saudi Arabia? With their customary consideration they made it a special point to impress upon me that it was a matter of my personal choice whether I cared to go or some other member of the staff was given the opportunity. My only question was as to the approximate length of the engagement and the answer of not more than three months took care of the question quite satisfactorily. You see, I have three brothers and two sisters in England, not to mention a considerable number of relations further removed, whom I had not seen for twenty years and, in addition to other features of the trip which appealed to me, this would give me the opportunity to satisfy my desire to renew acquaintance with them.

Travel and visa requirements were very efficiently taken care of by our client, leaving the only major personal chore to be undertaken that of medical inoculations against typhus, typhoid, fallen arches, etc. The first series of four "shots," out of a total of ten, was taken one Friday afternoon and my presence on the golf course early the following morning was more indicative of a determination to

keep a previously-made engagement than any desire on my part to play golf. Subsequent inoculations did not quite pack the kick of this first series.

Both on the trip out and the return from Saudi Arabia, all flying was done on Constellations, which are wonderful planes. Traveling within Arabia was something quite different, but more of that later. After arranging to join Mr. Giles on the New York-to-Bombay plane in Paris on May 15, I left San Francisco the morning of April 30 and arrived in New York about midnight E.D.S.T. An old friend was waiting for me when I checked into the New York hotel, and the two of us went to a well-known Seventh Avenue restaurant for a snack. In a moment of weakness I picked up the check and presented it with a hundred dollar bill to the cashier, who carefully examined the bill and then called over the manager to get his O.K. on it. This was given; I got my change to the accompaniment of explanations of the precautions being taken because of the large number of counterfeit bills which were being passed, and I left. Imagine my embarrassment when one of the twenty dollar bills given to me in change at this food emporium turned out to be counterfeit, and I was relieved of it two weeks later by the American Express Company in Paris when I tried to buy francs with it.

The departure from New York was made on Sunday evening and after a stop at Gander, Newfoundland, we made a smooth crossing over the Atlantic and sighted England about noon the following day. The country looked like one big patchwork quilt, the weather was excellent and, much to my amazement and gratification, it continued so during the length of my stay there, which contributed largely to the enjoyment of the ten days I spent in the country.

Twenty years of residence in San Francisco have made me somewhat prejudiced in favor of the Golden State and I am afraid my comparisons of it with other parts of the world always had the same answer.

So much has been and is currently being written about England, its trials and tribulations and its fight to return to a balanced economy, that I believe I can continue on to the next stop, Paris, without comment on this particular subject.

It was just a ninety-minute hop by plane from London to Paris, where I stayed for a little over two days, which was not much time to spend in a city as large and beautiful as this. Possibly I picked the wrong section of the city in which to do my sight-seeing, because the local promoters seemed to point their compasses in my direction and make contact as unerringly as a homing pigeon making for its

loft. There were the black market money changers, sellers of postcards (the type they flash before your eyes for a second and then withdraw), promoters of nude shows, hot spot excursions, etc., and of course the ladies of easy virtue. In retrospect, I don't know how I got out of that city as pure as I went in.

I spent the day of my departure from that gay city with Mr. David, our Paris partner. He had been out of town, and I was fortunate in the timing of his return. A very charming gentleman and an excellent host, his efforts to renew acquaintance with our Mr. Giles when the plane arrived were looked upon with great disfavor by the local gendarmerie. (You see, in-transit passengers on international flights like this are allowed no contacts with the outside world). Mr. Giles was accompanied by Mr. P. L. ("Paddy") Shobe, one of our client's top-flight administrative personnel who was proceeding to the Tapline division in Arabia, and Mr. Ralph Powers, who was to do some specialized work for the client in connection with the installation of Diesel equipment.

The plane was on the ground for approximately one hour, which was the average time of the stops on this T.W.A. flight from New York to Bombay, and we were air-borne late in the evening with the prospect of relatively short hops from Paris to Dhahran, Saudi Arabia. Stops were made at Geneva, Rome, Cairo, Basra, and then our immediate destination of Dhahran. The trip was uneventful and my principal recollections of it were (a) the concoction served at the Rome airport for coffee—I felt ashamed of my prior criticisms of the English and French brands, which on a comparative basis rated an "E" for excellent, (b) the blueness of the blue Mediterranean, and (c) the ribbonlike Suez Canal; these in the order of their occurrence.

Our arrival date in Dhahran, Sunday, was just another workday, the Moslem holy day being Friday, which is observed by Moslems and non-Moslems alike in Arabia as the seventh day of rest. Visibility was poor, due to a minor "Shamal" which is a northwest wind that kicks up a considerable amount of sand, the weather very definitely rated in the warm classification, and the wait for customs clearance, while of comparatively short duration, seemed like an age. I was relieved of my movie camera, which was to be returned to me later after its value had been determined and the duty assessed. And so on to the adjacent construction camp maintained by our client, out of the heat and the flying sand into an air-conditioned room and the luxury of a shower.

The Dhahran airport and U. S. Air Base is quite a large community by itself and is separated by several miles of the usual Arabian

wasteland from the Arabian American Oil Company town of Dhahran, which looks just like the very lovely pictures of it appearing in *Life Magazine* several months ago. It has fine streets, nice homes and gardens, and a community center embracing swimming pool, tennis courts, dance pavilion, eight bowling alleys, movies, etc.

Of the eleven weeks I spent in Saudi Arabia, I was located in Dhahran for two weeks, in Riyadh for five days, and the balance of the time in Jeddah.

Riyadh, the capital, is quite a city and it is not likely that I shall ever forget the conducted tour that we made one afternoon in a jeep. From the airport camp to town was about five miles over a good black-top highway recently constructed by our client, from which we branched off to a graded road which was bounded at some considerable distance to the right and left by walls which appeared to enclose some gardens, and by buildings which formed part of the city, respectively. Water is a scarce commodity in this area and it is necessary to dig deep wells to reach the supply; the community wells are not very numerous and of course all water has to be carted to the place of use.

To return to the tour of Riyadh. Our progress over the roads or streets was accompanied by more ups and downs than an elevator operator has in a day's work. It would not be difficult to justify a claim for a most liberal depreciation write-off on any equipment that has to work over those streets, most of which were extremely narrow, so much so that even the jeep did not have much room to spare in making the turns into cross streets. The buildings in the town, including the castles, were all of the same color and built of the same basic material—mud.

I felt quite honored to have assigned to me the one apartment in the Riyadh camp, but my enthusiasm was considerably dampened when I discovered that it was in a building block which was not yet air-conditioned. I suspected the nights were somewhat warm and the second night I borrowed a thermometer to confirm my suspicions; at 11 P.M. when I retired the thermometer read 98° and at 6:30 A.M. upon arising for my daily chores it also read 98°. During the day I do not know how warm, or perhaps I should say hot, it got inside that apartment, because the thermometer did not register that high.

Jeddah, on the Red Sea, was the third city where I worked, and where I spent most of my time. Jeddah (sometimes spelled Jidda or Jedda), viewed from the air or from a distance, gives one the impression of being a modern city, having quite an impressive skyline, and it is probably the most modern of all Saudi Arabian cities. Many

countries (including the United States) maintain Embassies or Legations here, some of the Saudi Arabian Government offices are located here, and it is a major port for the country's foreign trade.

About the third day after our arrival in Jeddah the mercury in the thermometers climbed to 119° and at that time the installation of the air-conditioning system in the office had not been completed. It was a trifle uncomfortable and the perspiration did not just ooze, it flowed all day long, which was conducive to the acquisition of a heat rash and which I promptly acquired. The following day it cooled down to 116°, and subsequent to this the temperature remained fairly constant in the 95° to 105° range, so that I got to believe that the stories I had been hearing of the hot weather in Arabia were pure propaganda.

The humidity in Jeddah is very high and metallic objects which are not specially treated for the elements soon show the effects. For example, the ordinary untreated steel wire door screens have an average life of about two months, and the majority of tail pipes on the exhaust systems of the older cars and trucks have fought a losing fight with this attacker of metals, so that one gets the impression from the exhaust noises of these pieces of equipment that he is in an American "Hot Rod" convention.

I found the city of Jeddah quite interesting, from the Embassy buildings, apartments, the large number of lovely homes, down to the very primitive living quarters of the poor. These latter took the form of all sizes, shapes, and forms of tents pitched on the sand. A great deal of private building, principally of homes, is in progress, and many of these are quite substantial structures, even judged by American standards. Invariably the first part of these construction jobs seems to be to build a wall around the property, and then proceed with the building of the house or houses. Some of these enclosures contain several units to house the families of the more prosperous Moslems.

There is no central electrification plant for supplying electricity to the town as a whole, but electric lights are very much in evidence through the medium of small generating plants, although the not inconsiderable shopping section of town, known as the Suk, relies on kerosene lamps for its lighting. Kerosene is also the native power which operates the numerous small fans in evidence in the Suk—they are not very effective but at least they do create a little agitation of the air. Refrigeration equipment in this Suk was very conspicuous by its absence, the heat breeds flies, and, as a result, this is probably the Shangri-la of the fly world, a really pugnacious brand of devils that

deeply resent being shooed away and return to the attack with alacrity. The natives, from long association with these pests, seem to accept them as a matter of course, but the Americans find them to be the finest medium in the world for the production of frayed tempers. My own defense against the annoyance was to chain-smoke cigarettes and face to windward. I am reminded of the story of the gentleman who completed an employment contract in Arabia and who stopped off in New York City on his way home. He was standing on Broadway looking up at the sights and every few seconds, purely from force of habit, he would wave the flies from his face with a motion of his hand. A policeman watched this procedure for a few minutes and concluded the case required investigation. After a little preliminary verbal sparring, the officer learned that the gentleman had just arrived from Saudi Arabia; that he didn't mind it over there at all; that some of the Americans just could not tolerate the flies; but that they (another motion of his hand across his face) didn't bother him at all!

The water supply for the city is piped to a few central locations but there are no feeder pipes, to my knowledge, to the points of use. The distribution of this water involves the expenditure of thousands of man-hours per day, the usual method being to fill round steel barrels, which are mounted on two-wheeled rigs drawn by donkeys, at the central distributing points. From there these contraptions wend their way to the points of consumption, where cans or appropriate receptacles are placed in position on the ground and very efficiently the crude wooden stopper is released from the hole in the barrel, the containers filled, and the stopper replaced. These donkeys seem to be well taken care of, but the pains taken with the appearances of some of them are quite extreme. I was a little worried about the reliability of my vision the first time I saw one of these animals with all four hoofs and portions of its body dyed a henna color. (He had made the journey to Mecca.) Another method of distribution, and one the sight of which usually accelerated the rate of perspiration, has been in use throughout the centuries, and I am referring to the carrying of two containers which are attached by ropes to a pole which is carried across the shoulders. These containers in use here were five-gallon cans, and the sole dress of the carriers, who usually operated at a trot on the outward journey, was a loincloth—understandably so, too, when you compute the weight of water contained in those two cans and the temperatures they had to work in. I concluded they operated at a trot with the full load in order to be rid of the considerable weight as

quickly as possible and thereby be able to relax at a staid walk on the return journey to the water faucets.

The water supply to the American camp was brought in from a central distributing point by tank trucks and pumped from the latter into a storage tank. Occasionally the demand exceeded the supply, or the pump might be temporarily out of commission, and on such occasions the sense of frustration would be particularly acute when I would, with great anticipation, step into the shower, turn on the faucet, and get two or three drops of water for my pains.

Jeddah has some good roads and streets, which are well traveled by autos and trucks. The large number of the latter was quite surprising to me, as was the almost continuous blowing of their horns, until one day I acquired a copy of the Revised Automobile Regulations of the Kingdom of Saudi Arabia, and the horn blowing ceased to be a source of surprise and wonderment after I read it. Let me give you a few quotes from said Regulations, covering incidental matters in addition to the sounding of the horns:

> He must slow down at the approach to a police station and sound his horn before he is within fifty meters of it at the least.
>
> When a driver, while driving his car in the daytime, meets the driver of another car, both must sound their horns and drive carefully. In similar circumstances at night, each must sound his horn and turn the lights of his car on and off several times, at a distance of not less than one hundred meters away from each other out of town and fifty meters in town, to prevent collision.
>
> A driver must sound his horn continuously at the mere approach of a pedestrian or mounted man or of camels or other animals and must slow down enough to avoid danger, until those in front take heed and get out of the way. (*Note:* There are almost as many goats on the streets of Jeddah as there are people, or so it appears on occasions.)
>
> If one or both of the automobiles in the collision is damaged, the driver who caused the accident shall be liable for the cost of the damage done and to imprisonment for a week to two months.
>
> If a driver drives his car into a ditch, a rock, or off a cliff or embankment, and it is proved that this was occasioned by his poor handling (of the car), he shall be fined the cost of the damage to the car and imprisoned for a week to two months.

I mentioned a little previously the presence of large numbers of goats on the streets of Jeddah. These seem to feed on anything and everything, digestible or indigestible, including paint, lumber, nails, etc., and it is an interesting sight to see the mamma goats wearing brassieres to save the milk for human consumption, thereby making it incumbent on their offspring to get out and forage for themselves.

Entertainment for the Americans in Jeddah is largely confined to what they are able to supply themselves, but a pleasant and much anticipated interlude is the weekly showing of movies on the roof of the U. S. Ambassador's home on the shore of the Red Sea. The movies, principally American, were invari-

ably of good quality shown in a delightful setting with the Red Sea to the right, the lights of Jeddah in the distance, and the moon and thousands of stars twinkling overhead—all this, coupled with light evening breezes, made it perfect for the complete enjoyment of a good movie.

During the time of my sojourn in Jeddah certain major jobs were in process of construction by our client involving dates of completion that required long hours of work by the available personnel in order to meet the projected schedule. The field forces commenced work at 6 A.M. and worked through to 6 P.M., with one hour off for lunch, with more seven working days per week than there were six; the office force was comparatively lucky, the working day running from 7 A.M. to 6 P.M. with one hour off for lunch. I need hardly add that, particularly as far as the field forces were concerned, after a shower and dinner the principal desire was not entertainment but just a yen to "hit the sack."

There was never any question as to the type of weather lurking around the corner, each morning started off in brilliant sunshine and continued so all day. Ordinary prudence dictated the use of sunglasses and the determination of the camera aperture to use when taking pictures was usually no problem at all—just close her down all the way.

Ramadhan, a religious observance extending over a period of thirty days, got under way one daybreak in June to the sound of the firing of cannon, and each daybreak and sunset for the thirty-day period the firing of these cannon in Jeddah signalized the start and end of the daily fasting period. During these daylight periods the Moslem refrains from either eating or drinking. In so far as our client was concerned, the Moslems were required to work only six hours per day during Ramadhan, in order to be entitled to eight hours' pay.

Without any formality, permission, or red tape I had the pleasure of visiting, purely in the role of sightseer, the Jeddah jail, where approximately fifty prisoners were housed to do penance for various and sundry crimes and misdemeanors. One unfortunate was kept there as a substitute for his brother, who was wanted by the police but could not be found. Another poor soul, a small young fellow whose I. Q. was evidently not of the highest, comparatively well dressed in a suit of clothes and shoes, picked up his little traveling bag and attempted to walk out past the soldier guarding one of the gates to the jail, but was unceremoniously "about faced" back to the stockade. This boy really wanted out, for I was informed that this performance was frequently repeated—he had landed in the country without a passport and

was being detained until such time as this matter could be rectified. Other prisoners were trekking in and out of the jail, busy on their chores of replenishing the water supply in the containers in the jail yard from the donkey-driven rigs I previously mentioned which were parked outside of the jail. All this, of course, under the watchful eye of the soldier on guard at the gate.

Travel across Arabia, a distance of 800 air-line miles from Dhahran to Jeddah, was accomplished via the Saudi Arabian Airline. Well do I remember the misgivings about making the first cross-country flight, particularly after one of the boys recounted his experiences on a recent crossing where the air had been a little bumpy and there had been much airsickness, as Mr. Giles and I, accompanied by the client's Administrative Manager, his wife and son, plus one other American and about twenty Arabs, boarded the plane one morning. The plane was a twin-engined cargo job acquired, "as is," from the U. S. Army. "As is" meant the steel skeleton, and I can testify very feelingly as to the hardness of American steel. The passengers sat on the steel bulkheads, over which had been draped thin woolen blankets, with the curving steel fuselage for a headrest. In between the passengers, who sat the length of the plane facing each other, was piled all the personal baggage of the passengers plus miscellaneous and sundry freight, all of which was held in place by ropes passed through steel rings in the floor. Where to put one's feet was no problem to the Arabs, at least the male gender, whose normal sitting position is with legs crossed on a level with their buttocks, but with the double hazard of the baggage and the Americans' feet to negotiate, it required the agility of a monkey to make the journey from the front to the rear of the plane.

After three stops, at Hofuf, Riyadh, and Taif, we finally put down at Jeddah about ten hours after leaving Dhahran. It was a very interesting trip, in spite of the discomforts of excessive heat while on the ground and extreme cold in the air. The flight, incidentally, was fairly smooth and airsickness was restricted to two or three people.

Finally, a few random thoughts, impressions, and related occurrences:

The formidable task of locating your imports among the acres of merchandise in the local Zambok (Customs Yard) on the occasions you did not intercept them at the time of unloading from the ship.

The thickness of the skin on the soles of the feet of the natives who did not wear shoes, which explained their ability to walk on ground which was hot enough to fry an egg.

The custom, discontinued generally in some other Moslem countries, of the veiling of all women in public.

(*Continued on page 35*)

The Fundamentals of Preparing Federal Corporation Income Tax Returns

By H. E. Bischoff
(*New York Office*)

This article is restricted to the preparation of working papers, the transfer of such data to the Federal income tax return and the mechanics of preparing the return itself without going into the ramifications of defining taxable income, deductions, net income, etc.

Audits made by the Bureau of Internal Revenue indicate that about one taxpayer out of every five files a return that is either erroneous or fraudulent.

It would appear that this ratio could be substantially reduced if taxpayers would make a more serious effort to read and follow carefully the instruction sheets accompanying the returns and maintain proper working papers.

As to individual returns, the 1949 Edition of *Your Federal Income Tax* recently released by the Treasury Department at 25 cents per copy should prove of great help to any one preparing such a return.

Corporation Returns

While admittedly the preparation of the Federal income tax return is, in most cases, more cumbersome and involved in the case of corporations than for individuals, nevertheless the margin for error should be considerably reduced if certain simple rules and prescribed procedure are followed.

Tax Working Papers: The first step is the classification and analysis of the trial balance taken from the books. This requires wide analysis paper preferably 14 or 21 columns.

The accounts shown by the trial balance should be divided into three groups and separate schedules prepared for each group as follows:

Group (1) Assets and Liabilities or Balance Sheet Work Sheet
Group (2) Income Work Sheet
Group (3) Deductions Work Sheet

Assets and Liabilities: The amounts shown on the books should first be adjusted as required for tax purposes and then grouped according to the classifications shown on the Balance Sheet submitted as Schedule L of the tax return through the use of the following columns:

Group 1

Column 1. Name and Account Number
2. Trial Balance per Books, Debit
3. Trial Balance per Books, Credit
4. Tax Adjustments, Debit
5. Tax Adjustments, Credit
6. Balance Sheet per Tax Return, Debit
7. Balance Sheet per Tax Return, Credit

Additional schedules, similar in style to that described above with reference to Group 1, may be prepared as to Groups 2 and 3 in cases where the tax adjustments are voluminous enough to require such treatment, or as an alternative the tax adjustments may be made in the related columns of the schedules next referred to below. To illustrate, (1) the trial balance is distributed under the appropriate headings in columns to the right. (2) When the columns are footed and proved, further adjustments for the tax purposes are made by entering the debits or credits of the adjusting journal entries in the columns in which they are to be classified below the first footing. (3) The columns are again totaled to give effect to the adjusting entries and the latter total is used for transfer to the tax return.

Income Work Sheet: The income accounts shown by the books are then grouped under Items 1 to 15 of Gross Income shown on page 1 of the tax return by use of the following columns:

GROUP 2

Column 1. Name and Account Number
2. Trial Balance per Books, Credit

Separate columns for each item of gross income or other income shown under Gross Income on Page 1 of Form 1120:

Column 3. Item 1, Gross sales
4. Item 4, Gross receipts
5. Item 7, Interest on loans, etc.
6. Item 8, Interest on corporation bonds, etc.
7. Item 9, U. S. interest
8. Item 10, Rents
9. Item 11, Royalties
10. Item 12(a), Net short-term capital gain
11. Item 12(b), Net long-term capital gain
12. Item 12(c), Noncapital gain or *loss*
13. Item 13, Dividends
14. Item 14, Other income
15. Nontaxable items
16. Dispositions of nontaxable items in Schedule M

Deductions Work Sheet: The same procedure as suggested for Group 2 above should be followed for Group 3 covering deductions calling for the following columns:

GROUP 3

Column 1. Name and Account Number
2. Trial Balance per Books, Debit

Separate columns for "Cost of Goods Sold" and "Cost of Operations" under Gross Income and all items shown under Deductions on Page 1 of Form 1120:

Column 3. Item 2, Cost of goods sold
4. Item 5, Cost of operations
5. Item 16, Compensation of officers
6. Item 17, Salaries and wages
7. Item 18, Rent
8. Item 19, Repairs
9. Item 20, Bad debts
10. Item 21, Interest
11. Item 22, Taxes
12. Item 23, Contributions
13. Item 24, Losses by fire, storm, etc.
14. Item 25, Depreciation
15. Item 26, Depletion of mines, etc.
16. Item 27, Amortization of emergency facilities

17. Item 28, Advertising
18. Item 29, Amounts contributed under a pension, annuity, stock bonus or profit-sharing plan
19. Item 30, Other deductions authorized by law
20. Unallowable deductions
21. Disposition of unallowable deductions in Schedule M

Transfer of Data to Return: After the amounts shown on the trial balance per the books have (A) been adjusted for tax purposes and (B) segregated to the respective classifications per the tax return as grouped under separate columns, the columns should be footed and crossfooted and, if in agreement, the totals shown in the related columns should be transferred to (1) Schedule L, Balance Sheets, (2) page 1 of the tax return, or (3) Schedule M, "Reconciliation of net income and analysis of earned surplus and undivided profits" as they apply.

With the aid of these schedules, which should be retained for future reference, it will always be possible to trace back to the books (1) the amounts reported on the tax return as either income, expense or balance sheet items, (2) the adjustments made for tax purposes, (3) the items of nontaxable income, or unallowable deductions, (4) the adjustments allowed for tax purposes not recorded on books, and (5) the surplus adjustments.

Consolidated Returns of Affiliated Corporations: The procedure to be followed in preparing consolidated tax returns is to (1) prepare the schedules with reference to Groups 1, 2 and 3 outlined above, and (2) transfer the separate figures of each subsidiary to a consolidating working paper.

In place of the book accounts per the trial balance there should be listed vertically in the first column the description of the items of income and deductions shown on page 1 of the tax return. The names of the parent and different subsidiary companies should be inserted horizontally across the tops of the columns; and the respective amounts of each subsidiary applying to each income and deduction item should be stated opposite that item under the column of that subsidiary. An elimination column should also be provided to record intercompany eliminations, e.g., interest, dividends, intercompany profit in inventory, etc., as well as a consolidated column covering the total of the columns of all subsidiaries after adjustment by the intercompany elimination items.

Where consolidated returns are filed the parent company must also file Form 851 "Affiliations Schedule" and each subsidiary must file Form 1122, "Return of Information and Authorization and Consent of Subsidiary Corporation Included in a Consolidated Income Tax Return." Two duplicate originals of Form 1122 must be prepared, one of the forms to be attached to the

tax return and the other filed in the office of the collector for the district prescribed for the filing of a separate return by the subsidiary.

The Bureau has ruled that affiliated corporations which filed consolidated income tax returns for the fiscal year ended in 1948 may elect to file separate income tax returns for the fiscal year ending in 1949. However, as to affiliated corporations that filed consolidated returns for the calendar year 1948 the Bureau has ruled that separate returns cannot be filed for the calendar year 1949 unless permission is obtained from the Commissioner or a new subsidiary has been added to the group.

Care should be taken before making a decision to file a consolidated return, in view of the additional surtax (2% at present) imposed when computing the tax in case of a consolidated return. Whereas for the current year a consolidated return may appear advantageous, in view of the elimination of intercompany dividends and application of losses of one or more subsidiaries to the profits of others, such temporary advantages may be offset in future years by the additional tax rates, if the intercompany dividends and offsetting losses, etc., are reduced to the point where their tax savings no longer exceed the additional tax imposed and the group may not then be permitted to file separate returns.

Adjustments of Prior Years: In those cases where adjustments have been made in prior years which affect the current year, separate schedules should be maintained and revised annually to give effect to new additions, etc., so that such adjustments will not be overlooked in the current return. The following are some examples: (1) repair items previously written off on books but capitalized by revenue agent when returns of prior years were examined and therefore being depreciated over subsequent years; (2) patents written off on books when acquired but being amortized for tax purposes; (3) differences between books and tax returns as to depreciation or amortization due to changes in depreciation rates allowed by Treasury; (4) differences between profits or losses on assets sold or otherwise disposed of due to adjustments by Treasury of tax basis or accrued depreciation.

Bad Debts: Where a taxpayer reports on an actual bad debt basis a deduction may be claimed for debts which became worthless in whole or in part during the taxable year. If a debt became only partially worthless during the year so much as is charged off during that year may be deducted. The taxpayer should gather in a separate file data supporting the identifiable event establishing the worthlessness of the debt, i.e., correspondence with collection agencies, reports from lawyers, notices of final distribution by receiver, etc., so that

such data may be furnished the revenue agent when he examines the return.

If the taxpayer is on a reserve for bad debt basis a reasonable addition to the reserve may be deducted in the taxable year. Proof of the reasonableness of the amount must be furnished by filling out Columns 2, 3, 5 and 6 of Schedule G, page 2 of the return. In the case of a corporation using the actual bad debt method, Column 4 (actual amounts charged off) is required to be filled in instead of Columns 5 and 6.

Recoveries of Bad Debts and Taxes of Prior Years: If the income account for the current year shows recoveries of bad debts or state or local taxes which had been claimed as deductions in the tax returns of prior years, an investigation should be made to ascertain whether or not a tax benefit resulted for the year in which the deduction was claimed. If not, the recovery is treated as nontaxable income in the current year to the extent of the previous nonbenefit. In order to facilitate this it might be desirable to maintain a separate record showing (1) those years in which losses were reported and not availed of for tax purposes as well as (2) the amounts deducted in such years for bad debts and state and local taxes.

Contributions or Gifts Paid: So-called contributions per the books should be examined to ascertain whether they are really contributions subject to the 5 per cent limitation or ordinary and necessary business expenses not so limited, e.g., donation to hospital where the hospital provides special services to taxpayer's employees, Chamber of Commerce dues, etc.

A test should be made to ascertain whether or not the amount claimed for contributions or gifts paid exceeds 5 per cent of the corporation's net income as computed without the benefit of that deduction. Any excess must be treated as an unallowable deduction. (See reference below with reference to The Technical Changes Act of 1949 affecting contributions.)

Capital Loss Carry-Over: Schedule C, "Schedule of Capital Gains and Losses," must be filed with the corporation's income tax return, Form 1120, in the case of sale or exchange of capital assets. The amount of a net capital loss sustained in any taxable year beginning after December 31, 1941 may be carried over and applied as a short-term capital loss against capital gains for each year for the next succeeding five years until such loss has been offset by such gains. Unless a separate schedule is kept of such losses showing how they have been applied in the years intervening between the year in which the capital loss was sustained and the current year it is likely that the benefit of the loss carry-over may be overlooked.

Net Gain or Loss from Sale or

Exchange of Property Other Than Capital Assets: Under Section 117(j) of the Code as amended in 1942 net gains from sale or exchange of depreciable business property, business real estate, and involuntary conversion of such property and of capital assets, if held for more than six months, may be taxed as capital gains whereas losses sustained from such transactions may be taken as ordinary deductions. Accordingly, where such gains are realized by a taxpayer paying normal and surtax at rates totaling over 25%, e.g., 38%, it would prove advantageous to treat the gains as capital gains and save the difference between 25% and 38% of the tax on the gain. It furthermore may be possible to apply against the capital gain for the current year the capital loss carry-over of prior years outlined above. Each year the transactions of the nature described in this paragraph should be reviewed carefully to ascertain whether or not the maximum benefit is being obtained under the method of reporting gains or losses for tax purposes.

Net Operating Loss Deduction Carry-Back and Carry-Over: Taxpayers are allowed first to carry-back their net operating losses from a trade or business to be applied as a deduction from income of the two preceding taxable years and to apply the excess, if any, of such loss to the income of the two succeeding taxable years. In arriving at the net operating loss the Code provides that (1) only ordinary depletion shall be deducted, if such ordinary depletion is less than percentage depletion or depletion based on discovery value used by the taxpayer; (2) wholly tax-exempt interest, less any non-deductible interest paid or accrued to carry the exempt securities, shall be included in gross income; (3) the net operating loss deduction shall not be allowed in computing a net operating loss; (4) the deduction of short-term and long-term capital losses is limited in each case to the amount of like gains; (5) for taxpayers other than corporations, deductions not attributable to trade or business are allowed only to the extent of gross income not derived from trade or business, and (6) the excess profits tax shall be deducted. Unless care is taken to maintain a separate record of such net operating losses and the manner in which they have been or are being applied it is possible the claiming of such loss may be overlooked in the current year.

Extension of Time for Payment of Taxes: A corporation expecting a carry-back loss from its current fiscal year may obtain an extension of time for payment of all or a part of the taxes for the year immediately preceding that of the expected carry-back by filing Form 1138, Statement for the Purpose of Extending Time for Payment of Taxes by Corporations Expecting Carry-Backs.

In general, the extension expires when the Commissioner gives notice of the action taken by him on Form 1139 (see below). Interest will be charged at 3 per cent per annum on the amount satisfied by the net decrease in tax determined through the filing of Form 1139, and at the rate of 6 per cent on any excess. A penalty of 5 per cent may be imposed on any excess over 125 per cent of the tax, the time for payment of which could properly be extended.

Tentative Carry-Back Adjustment: A corporation filing a return indicating that the taxpayer is entitled to a loss carry-back may file Form 1139, Application for Tentative Carry-Back Adjustment, showing the refund of prior year taxes due as a result of the carry-back. The Commissioner is obliged to credit the amount claimed against other taxes due from the taxpayer and to refund the balance within 90 days, unless he decides to disallow the application because of material errors. It is ordinarily desirable to file Form 1139 soon after the completed return reporting the loss is filed although it may be filed within 12 months from the end of the year in which the loss arises. In any event a claim for refund with reference to the loss carry-back should be filed on Form 843 in order to start the running of interest on the refund if and when subsequently allowed.

Balance Sheet Items: The amounts reported on Schedule L, Balance Sheets as of the beginning of the current year should correspond to the amounts reported as of the close of the year in the return filed for the previous year and where any differences occur a reconciliation or explanation of such differences should be submitted with the current return.

The inventories at the beginning and end of the taxable year shown on Schedule A, page 2 of the return, should agree with the corresponding inventories reported on Schedule L. Likewise the cost of fixed assets and accrued depreciation shown on Schedule J, page 2 of the return, should be reconciled with the corresponding figures on Schedule L.

Analysis of Reserves: The working papers should contain an analysis of the so-called unallowed reserves for tax purposes, e.g., reserves for guarantees or contingencies, etc. The additions to such reserves may not be taken as a deduction and the charges against such reserves are allowable deductions. The working papers should provide the following columns:

1. Description of reserves.
2. Balance at beginning of year.
3. Additions to reserves, unallowable deductions.
4. Additions to reserves, transfer, etc., allowable deductions.
5. Charges to reserves, allowable deductions.
6. Charges to reserves, transfers, etc., unallowable deductions.
7. Balance at end of year.

The balances at the beginning and end of the year (Items 2 and 7) should agree with the amounts shown opposite "Surplus Reserves" on Schedule L, page 4 of the return, and the unallowable deductions and allowable deductions under Items 3, 4, 5 and 6 reconciled with the adjustments reported in Schedule M, Reconciliation of Net Income and Analysis of Earned Surplus and Undivided Profits.

Tax Computation: Reference to page 3 of the return will disclose that for normal tax and surtax purposes the tax is computed at different rates in the case of taxpayers reporting net income of $50,000 or less from those reporting over $50,000. Care should be taken that in computing the tax this fact is not overlooked and the proper rates are applied.

In the case of net long-term capital gains the alternative tax provided for at the bottom of Schedule C should be computed and compared with the total normal and surtax shown on line 12, page 3, of Form 1120. Whichever is the lesser tax is the one to be reported on line 35, page 1 of Form 1120, and after reduction for credit for foreign tax (if any) is the balance of income tax due for the taxable year.

Questions: All of the questions at the bottom of page 3 of the return should be answered and in those cases where the questions are not applicable to the taxpayer, words to that effect should be inserted.

If the taxpayer is claiming a deduction for amounts contributed under a pension, annuity, stock bonus or profit-sharing plan, assuming the plan has been approved by the Treasury it is necessary that a statement be submitted with the return showing the information specified at paragraph 29, page 6, of official instructions:

The Technical Changes Act of 1949: Some of the changes brought about by this Act which should be of interest follow:

(1) Corporations on the accrual basis may elect to treat a charitable contribution as paid during the taxable year if such contribution was authorized by the Board of Directors during the taxable year and if it was paid before the 15th day of the third month following the close of such taxable year. Previously such contributions were deductible only in the year in which paid. The amendment is retroactive to open years beginning after December 31, 1942; election to have it apply to years beginning prior to January 1, 1949 must be made before October 26, 1950. Claims for refund may be filed for such open years and assessment may be made for any year affected by the shift.

(2) Requirement that a corporation must submit a list of names of officers and employees paid over $75,000 annually is dispensed with.

(3) Requirement of oath on returns may be dispensed with at Commissioner's discretion. (Reference to page 1 of corporation income tax return for the calendar year 1949 and fiscal years

ending in 1950 will disclose that the return need not be notarized.)

Extra Copies: It is assumed that copies of the returns and supporting schedules will be retained by the taxpayer for future reference. In some instances where the style of supporting schedules is not changed to any great extent from year to year the chief change being in the amounts reported, it has been found helpful to make extra copies of such schedules for use in preparing the return for the succeeding year by merely substituting the revised figures.

Where the taxpayer also files a number of State tax returns for the same year the procedure is often followed of having extra copies made of the main schedules (by mimeograph, ditto, multilith, etc.) and submitting these with the State returns, e.g., balance sheets, Schedule M, Reconciliation, Schedule F, Compensation of Officers, Schedule J, Depreciation, etc.

General: It is suggested that proper names, addresses, etc., be printed to assist the typist who may not be familiar with the handwriting of the person preparing the return; that where the space for schedules provided by the form is too small separate schedules be prepared, attached to the return and cross reference made thereto, and that all calculations be verified by someone other than the person preparing the return.

Furthermore, copies of the return and all related working papers should be kept in one large envelope or binder and there should be pasted on the outside of such file a record of all payments made as well as any Consents, Form 872, "Consent Fixing Period of Limitation upon Assessment of Income and Profits Tax," so that there is always in sight the period of limitation for assessing additional taxes or claiming refunds. Provision should be made to review the file periodically so that such period as regards claims for refund does not run against the taxpayer without his knowledge.

Period for Which Old Records Should be Maintained: The Head of the Records Division of the Bureau of Internal Revenue recently advised an inquirer that the Bureau has no set rule as to what accounting records should be kept to support corporation income tax returns and returns of wages withheld at source. However, they recommend that taxpayers keep all supporting data for at least five years.

Relief Under Section 721

An Analysis of the Morrisdale Coal Mining Co. Decision

BY JULIAN O. PHELPS
(*Chicago Office*)

The high rates of tax imposed by the federal excess profits tax law in effect for the years 1940-45 induced Congress to insert several provisions in the law under which corporations might apply for relief. The two most generally invoked provisions are Section 721 relating to abnormalities in income in the taxable period, and Section 722 relating to abnormalities in the base period. The large number of claims filed under Section 722 and the special procedure set up for handling them have greatly slowed down the Treasury Department in its processing of the claims. Accordingly, only a relatively few Section 722 cases have gone up on appeal to the Tax Court. The result is that the Tax Court, as yet, has had little opportunity to pass upon the validity of the voluminous regulations and rulings issued by the Treasury under Section 722 which are generally designed to limit the allowable relief. Section 721 claims, on the other hand, being very much fewer in number have been handled by the Treasury as part of its regular examination of the tax return for the year involved, with the result that there presently is a considerable body of Tax Court decisions interpreting the extent of relief allowable under Section 721.

The taxpayer's success in *Morrisdale Coal Mining Co. v. Com'r.* (13 T. C.—No. 61), promulgated September 30, 1949, follows a trend which has become increasingly evident of late in Section 721 decisions. It appears that the Tax Court is not too much impressed by the many rules established by the Treasury Department in its possibly over-zealous desire to protect the public revenues against taxpayers' claims for excess profits tax relief. On the contrary, the Court has shown a consistent intent to give relief where it is due under Section 721, and to refrain from burdening the taxpayer with insuperable difficulties of proof. The result in the *Morrisdale* case bears witness to this intent.

To summarize the facts, in 1940 the Morrisdale Coal Mining Co. was operating several underground coal mines in Pennsylvania. Since these mines were approaching exhaustion, it acquired the mining rights to a new location and started development work, all about the middle of 1940. In March of 1942, mining rights to a tract adjacent to the new location were acquired.

The new mine was extended underground into this second tract, and the original entrance and surface facilities were used for the work of both parts of the mine. The development of the combined property was completed in September, 1942. The taxpayer claimed relief under Section 721 (a) (2) (C) for the year 1943. It contended that the income from its new mine, being the result of development work in prior years, was attributable to those prior years for excess profits tax purposes.

Judge Van Fossan's majority opinion sheds light on four problems which frequently confront claimants under Section 721. The opinion does not offer much in the way of definite statements of principles. This may be just as well, since the factual situations vary so widely in these cases. As in the past, the Court reaches a conclusion based on a broad interpretation of the Section. It declines to become involved in a meticulous scrutiny of all the technicalities which can conceivably be interposed between the taxpayer and relief.

The above-mentioned four problems, which are considered separately herein, may be stated as follows:

(1) What development is taken into account?

(2) To what extent must the development income be segregated into "items"?

(3) What income is attributable to activities other than development?

(4) What adjustment is required for changes in business conditions, etc.?

INCOME FROM DEVELOPMENT

The Commissioner contended that the taxpayer's income from development in 1943 must include the income from the old mines as well as from the new mine, since presumably the old mines also had been developed at some time in the past. In rejecting the contention the Court pointed to the definition of the "separate class of income" in Section 721 (a) (2) (C): "income resulting from . . . development . . . of tangible property . . . extending over a period of more than 12 months." The Court found that the income from the new mine met this definition and such income was therefore a "separate class of income." It decided that, under the statute, no further attention need be given to income from the old mines.

A comment in the dissenting opinion of Judge Disney, the lone dissenter, may give the basis for the conclusion reached by the majority. Apparently he believes that the majority would permit income from development of a *single* tangible property to constitute a "separate class of income," even though several properties had been developed. This is opposed to

his interpretation, which is that *all* income from development of *all* tangible property must be aggregated to arrive at the "separate class of income."

It may be noted that a somewhat similar question arose in *Geyer, Cornell & Newell, Inc.* (6 T. C. 96(A)), a case involving an advertising agency. The question was the classification of income which did not fall into any of the six classes in Section 721 (a) (2) (A) to (F). Specifically, could the income from *each* client constitute a "separate class of income"? The Court did not find it necessary to decide the question but it did state that "no valid objection to such separate classification occurs to us." Possibly in the *Morrisdale* case, the Court considered that similar treatment could be accorded under subparagraph (C) with respect to the income from each property.

A more likely basis for the conclusion here is suggested in the statement in the majority opinion that, "All of (the old mines) had been for some time in the production stage." While the opinion does not emphasize this point as a support for the decision, it is consistent with the findings in *Knight Machinery Co.* (6 T. C. 519) dealing with machine tools, and *Soabar Co.* (7 T. C. 89A) dealing with textile ticketing equipment. In the former case, a radically changed product was marketed in the test period, for which relief was allowed. In the latter case there was no internal change in the business in the tax year or test period and relief was denied.

Thus, the *Morrisdale Co.* case seems to follow the pattern previously established, although the resemblance certainly is not emphasized in the opinion. A development qualifies for the purposes of Section 721 (a) (2) (C) if it had not passed beyond initial exploitation stage by the beginning of the test period. Where there is income in the tax year from a development fully exploited before the test period, it would seem that such income is not to be taken into account under Section 721.

"Items of Income"

As previously mentioned, the new mine was operated under two distinct leases acquired from two distinct landlords. The majority opinion gives considerable attention to the Commissioner's contention that the income from each lease must be treated separately. While the importance of this question is not clearly explained, the Commissioner may have contended that income from the second lease did not qualify under *Section 721,* since the development of that lease was completed less than 12 months after the acquisition.

The Commissioner relied on his Mim. 6082 issued in 1946, which supported his position. The prop-

erty being operated as a single economic unit, it is to be expected that a computation on the Commissioner's basis, necessarily reflecting arbitrary allocations of costs between the two leases, would have been of dubious value. The Court considered the circumstances as well as decisions on a related point involving depletion. It concluded that it was not bound by Mim. 6082 and that the operation should be treated as a single property the development of which extended over a period of more than 12 months, thus meeting the time requirement in Section 721 (a) (2) (C).

In the *Morrisdale* case the meaning of "items of income" and "units of property" had technical aspects peculiar to operators of mines and oil wells. However, a similar problem frequently arises in cases involving manufacturers. For example, a concern may enter upon a development project of great promise. It is known that the project will lead into unexplored territory and at the beginning there can be no certainty as to its future course and the ultimate goals. As the development proceeds, it makes possible the marketing of new products from time to time. The cost of developing some particular one of these products can be obtained only by arbitrary allocations. The period of development of any of the products may be considered to begin with the original project. For example, in *Knight Machinery Co.*, the taxpayer developed a new type of machine tool. From time to time it offered a new model of the same general type. Similar examples may be found in the chemicals and other industries.

The conclusion of the Tax Court in this phase of the *Morrisdale* case is an indication that an equally broad view will be taken in Section 721 cases involving other industries. Thus, the taxpayers may be spared from dividing and subdividing their development operations to arrive at minute "items of income" for each of which a separate and meaningless accounting may be required under the regulations.

Income Attributable to Other Activities

The Regulations provide that "if the taxpayer engages in manufacturing, marketing, . . . or similar activities, only such portion of the resulting income as is attributable to . . . development is within the class of income described in this section." (Sec. 35.721-7, Reg. 112.) It must be a rare situation where a definite part of the income from a newly-developed product is clearly attributable to development, and the balance of the income is clearly attributable to other activities such as manufacturing. If the rule is to be enforced, some arbitrary allocation is required. For example, the Treasury Department sometimes insists

that two-thirds of the income from a particular product may be attributed to development.

In the cases where the Tax Court has approved the granting of relief, it seems generally to have paid a minimum of attention to the presence of activities other than development. In *Knight Machinery Co.*, the entire income from the new products was treated as development income. The adjustment made in *Rochester Button Co.* (7 T. C. 529) for loss of income from old products supplanted by the new products may be remotely a result of the rule. Mention was made of this point in later cases, including *Ramsey Accessories Manufacturing Corp.* (10 T. C. 482) and *Keystone Brass Works* (12 T. C., No. 80).

To quote from the opinion in *Knight Machinery Co.:*

> The statute deals with the source of the income, not the character of the taxpayer's activities, whether they be single or multiple. The property of the petitioner was developed in order to enable it to carry on its business. The abnormal income was derived from the sale of that property.

The view expressed in the quotation is in accord with the literal meaning of the words "Income resulting . . . from development" in Section 721 (a) (2) (C). There may be several activities which contribute to the profit realized on the sale of a product. It cannot be gainsaid, however, that the entire profit is a consequence of the fact that there was, initially, development.

It is encouraging to note, in the *Morrisdale* case, that no reference is made to income attributable to activities other than development.

Business Factor

Beginning with *Knight Machinery Co.*, the Court has recognized that income resulting from improvement in business conditions is not to be attributed to prior years. This is in accord with the general intent of the excess profits tax, that war profits are to be subject to the tax. The usual procedure is to find some index measuring conditions in the taxpayer's industry. The improvement shown by the index number for the taxable year over the average for the four-year test period is then determined. If, for instance, this improvement is 20 per cent, then the net abnormal income otherwise attributable to earlier years is reduced by 20/120ths of itself.

In the *Morrisdale* case, the adjustment was made by the elimination of that part of the selling price per ton representing an increase over the average price for the preceding year, less the increase in average cost of production, or a net amount of 6.45 cents per ton. Possibly only business conditions in a staple commodity such as coal may be measured better in this way than by an index and the method does not have wide application.

It is nevertheless a departure from previous usage and may be helpful in the prosecution of claims still unsettled.

The increase in average cost of production per ton from 1942 to 1943, as taken into account by the Court, was 39.56 cents (against an increase in selling price of 46.01 cents). In *Southwestern Oil & Gas Co.* (6 T. C. 1124), the Commissioner contended that an increase in income was the result of a decline in costs and therefore not attributable to prior years. The Court rejected this contention on finding that the cost of each unit produced declined as the volume from a new property increased, but the prices of services and materials purchased had increased rather than declined. In the *Morrisdale* case, sales from the new mine rose from 78,508 tons in 1942 to 203,909 tons in 1943. It seems likely that the increase in costs would have been much more than 39.56 cents per ton had there not been savings due to increased volume. Possibly this point can be raised to reduce the adjustment for improvement in business, where unit costs enter into the calculation.

Dissenting Opinion

Two of the objections made in the dissenting opinion appear not to take into account certain rules provided in the Regulations. According to this opinion, the taxpayer admits that the income from the new mine is of a class normally received by the taxpayer. The taxpayer is therefore admitting, the opinion continues, that all the income from the old and the new mines falls into the same class, i.e., income from development (a result which would probably be fatal to the claim). However, the Regulations state (Sec. 35.721-1, Reg. 112) that if the taxpayer received any income of the same class in the preceding four years, then it is normal for the taxpayer to receive income of that class. But the taxpayer did receive income from the new mine in 1942, a prior year, and therefore there does not seem to have been any admission as to similarity, as to class, of income from the old and new mines if the Regulations are valid on this point.

The dissenting opinion objects to the computation of average gross profit from the mine for the four-year test period. It is said to be improper to compute the average by dividing by four the gross profit of the single year in the test period for which there was a gross profit. The complaint is made that three years in which there was no production cannot logically be used in determining average gross profit for the test period. However, the Regulations use as an example a case where there was no production

(*Continued on page 30*)

The Prize-Winning Articles for 1949

In the December, 1948 issue of the JOURNAL announcement was made that the firm would award two cash prizes annually, one of $1,000 and another of $500, for the best articles on accountancy or related subjects accepted and published by the *Journal of Accountancy* and written by members of our staff. An annual prize of $500 for the best article published in the L. R. B. & M. JOURNAL also was announced. The judging of articles and selection of prize winners for the 1949 awards have been made entirely outside our organization by persons associated with the American Institute of Accountants and The New York State Society of Certified Public Accountants, and we are pleased to announce the results, as follows:

For articles published in the *Journal of Accountancy*—

First prize—$1,000. Awarded to ARNO R. KASSANDER for his article entitled "Centralized vs. Decentralized Accounting Organizations: How to Decide Which to Use."

Second prize—$500. Awarded to HAROLD I. SCHLENKER for his article entitled "A Simple, Effective Cost Accounting System for a Public Accountant's Office."

For the best article published in the L. R. B. & M. JOURNAL—

Prize—$500. Awarded to J. WALKER VORIS for his article entitled "How to Make Money Selling Tickets."

The number of articles submitted by staff members during 1949 was smaller than was anticipated when the prizes were originally established. It is hoped that the announcement of prize-winners for 1949 will stimulate a wider interest in the competition for the 1950 prizes.

The L. R. B. & M. Journal

Published by Lybrand, Ross Bros. & Montgomery, for distribution to members and employees of the firm.

The purpose of this journal is to communicate to every member of the staff and office plans and accomplishments of the firm; to provide a medium for the exchange of suggestions and ideas for improvements; to encourage and maintain a proper spirit of cooperation and interest, and to help in the solution of common problems.

Montgomery's Tax Manuals

The 1949-50 editions of Montgomery's *Federal Taxes—Corporations and Partnerships*, and *Federal Taxes—Estates, Trusts and Gifts*, will be published this month.

Federal Taxes—Corporations and Partnerships, of which Colonel Montgomery, Mr. Taylor and Mr. Richardson are the authors, covers the same subject matter as the previous edition, and has been revised to reflect the developments of the year, including court decisions, new legislation, amendments to the regulations, and Treasury rulings. Outstanding among

the new court decisions is the *Culbertson* case and the discussion of family partnerships has been extensively rewritten to reflect the shift in emphasis resulting from the Supreme Court's decision. All the applicable provisions of the "Tax Administration Act of 1949" and the "Technical Changes Act of 1949" are discussed.

Federal Taxes — Estates, Trusts and Gifts, of which Colonel Montgomery, James O. Wynn, Esq., and G. Harold Blattmachr, Esq., are the authors, treats the income tax on decedents, estates and trusts, as well as the estate tax and the gift tax. It also has been revised to reflect the developments of the year, notably the Supreme Court decisions in the *Church* and *Spiegel* cases, which enlarged the scope of property which is includible in an estate for estate tax purposes, because of a retention of an interest by the decedent or a possibility of reversion to him. Provisions of the "Technical Changes Act of 1949" designed to avoid the retroactive application of these decisions in certain situations, but to extend the application of their principles in the future, are discussed, together with the other court decisions, legislation, regulations, and Treasury rulings which are pertinent to the subject of the book.

The 1949 Training Class

The first session of the 1949 training school for new staff members was held during the six-week period ended October 19. The school was held in a large classroom of the downtown branch of New York University and was again conducted by Philip L. Defliese.

While the school was intended primarily for members of the New York office staff, the complement of 28 men included one man from the Baltimore office and one from the Cleveland office. Practically all of these men, ranging in age from 20 to 32 years (average 26), had served in the armed forces; 27 were college graduates; 2 held master degrees. Most of their college work was completed after discharge from military service. Previous business experience varied from none to about 5 years; most of the men had had less than one year of public accounting experience. Seven of the men of this class had been with the firm during the 1948-1949 busy season as college trainees under the internship program now conducted in cooperation with certain colleges.

Generally, each day started with a lecture by a member of the New York staff which was followed by a question and answer period and some supplementary comments by the instructor. The role of the junior accountant in each phase of the audit was emphasized. The balance of the morning was devoted to work on the practice set or problems. Afternoons were devoted to student talks and a continuation

of work on the practice set and class problems.

Lectures were of three kinds: (1) relatively formal talks by members of the New York office staff; (2) appearances by partners; (3) informal discussions by the instructor. The subjects assigned were practical and many of the seniors made excellent presentations, correlating their talks with specimen working papers distributed at the time. A new feature in the form of an alumni forum was tried out this year. Representatives from the three post-war training schools appeared before the group and related their diversified experiences on the staff and the progress they had made in public accounting. This proved very interesting and facilitated the orientation of the new staff members.

Montgomery's Auditing

In our last issue the receipt by Col. Montgomery of the 1948-1949 Annual Award of the American Institute of Accountants for the outstanding book in the field of accounting was reported. We believe our readers will be interested in the reproduction of the Award shown facing page 30.

The T. Edward Ross Bible Collection

The following item appeared in the November-December issue of *The Spokesman,* which is the official organ of the Pennsylvania Institute of Certified Public Accountants:

MR. ROSS COMPLIMENTED

The GENERAL MAGAZINE AND HISTORICAL CHRONICLE of the University of Pennsylvania for Autumn 1949 contained an interesting article entitled "The English Bible on the Anvil."

It was written by Charles C. Butterworth, M.A. and based on the T. Edward Ross Collection of English Bibles, "containing some of the most valuable books in the world." Mr. Ross presented this complete library to the University a couple of years ago and it is housed in the Rare Book Room of the University Library.

Relief Under Section 721

(*Continued from page 26*)

in any of the four years (Sec. 35.721-1(b), Example (2), Lease Y, Reg. 112).

RECOVERY

The Treasury Department is reported to be guided sometimes by the rule that all claims, however meritorious, must be settled for amounts substantially less than the amounts claimed. It is encouraging to note that the net abnormal income of $92,594.02 as computed by this taxpayer was reduced only 14.2 per cent. (6.45 cents × 203,909.8 tons = $13,152.18 = 14.2 per cent of $92,594.02) The amount of reduction in tax is not apparent from the published decision.

The American Institute of Accountants

Annual Award

1948 — 1949

for the outstanding book or article in the field of accounting published during the year

is presented to

[redacted]OLONEL

[redacted]OBERT [redacted]. [redacted]ONTGOMERY

in recognition of the value to the profession of his book,

Montgomery's Auditing

the seventh edition of which was published this year.

Percival F Brundage
President

John L Carey
Executive Director

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Notes

Boston Office

Mr. Perry, Chairman of the American Institute Board of Examiners, was one of the speakers at the annual meeting of the Association of Certified Public Accountant Examiners held in Los Angeles. The subject of his talk: "The Work of the Board of Examiners."

The November issue of *News Bulletin* of the Massachusetts Society of Certified Public Accountants, Inc. contained an article by Mr. Joseph B. Fyffe entitled "The System Engagement for a Client with One Clerk."

Appointments to Committees of the American Institute of Accountants include the following members of our Boston office:

Mr. Harvey—Chairman, Committee on Technical Sessions

Mr. Perry—Committee on Meetings

Mr. Hunter—Committee on Cooperation with Bureau of Economic Research

Mr. White—Committee on Systems and Internal Accounting

Mr. F. E. Moore—Committee on Membership

Appointments to Committees of the Massachusetts Society of Certified Public Accountants, Inc. for the 1949-1950 season include the following members of our Boston office:

Mr. Perry—Member of Past Presidents' Advisory Committee

Mr. Harvey—Member of Legislation Committee and Past Presidents' Advisory Committee

Mr. Hunter—Member of Past Presidents' Advisory Committee

Mr. Walker—Member of Meetings Committee

Mr. F. E. Moore—Chairman of Membership Committee

Mr. J. K. Sanborn—Member of Publications Committee

Mrs. Ruth M. Welton—Chairman of History Committee

Francis E. Moore was appointed Chairman of the Plant Visitation Committee of the Boston Chapter of the National Association of Cost Accountants.

Chicago Office

Mr. Carl W. Lutz and Mrs. Mary T. Scott recently completed twenty-five years of service with the firm and were inducted into membership in the Quarter-Century Club. Appropriately engraved watches were presented by the firm to these new members.

Cincinnati Office

Mr. Charles L. Schmidt was re-elected secretary and made a member of the Executive Committee of the Ohio Society of Certified Public Accountants. He has also been appointed a member of a committee known as Motor Transportation Accountants of Ohio. The duty of

this Committee is to recommend a Uniform System of Accounting for Motor Carriers to the Public Utilities Commission of Ohio.

Mr. Dennis spoke on November 1 before the Twenty-Fifth Annual Meeting of the American Machine Tool Distributors' Association in Cincinnati on "How to Read Your Customers' Financial Statements."

Detroit Office

Mr. Russell spoke at the St. Louis Chapter of the National Association of Cost Accountants on October 18, 1949 on the subject "Pricing for a Stable Economy." He also addressed the regular November meeting of the Rockford, Ill. chapter of the N. A. C. A. on "The Function of Cost in Pricing."

Mr. John J. Fox is instructing a class in auditing at the Walsh Institute of Accountancy in Detroit.

Houston Office

Mr. Crouch is currently serving as the Chairman of the Houston Chapter of the Texas Society of Certified Public Accountants.

Los Angeles Office

At the time of the American Institute of Accountants Annual Meeting in November, the Los Angeles office was host to nineteen partners and fifty-eight staff men, principally from the West Coast area, although the East was well represented by Colonel Montgomery and Messrs. Sinclair, Schaffer, Jennings, Halloran, Hawes, Hewitt, Hunter and Perry.

Mr. Edwin B. Cassidy is serving for the second year as a member of the Committee on Accounting and Auditing Procedure of the California Society of Certified Public Accountants.

Mr. Carl F. Horn was successful in the November C. P. A. examinations.

Pittsburgh Office

Members of the Pittsburgh staff have been appointed to the following committees:

American Institute of Accountants:
- Social Security—Mr. Theodore L. Koos

Pittsburgh Chapter, Pennsylvania Institute of C.P.A.'s:
- Membership—Mr. Foster L. Reed
- Public Information—Mr. Theodore L. Koos
- Executive—Mr. Duncan Bruce
- Mr. Marsh is Chairman of the Committee for Cooperation with other Professional Groups.

In September, Mr. R. K. Conrad addressed a meeting of the Pittsburgh Chapter of the Pennsylvania Institute on the topic "Tax Aspects of Allowances for Traveling, Entertaining and Business Expense."

The *Tax Law Review* for November, 1949 contains a review of "Tax Practitioners Forum," a volume containing six lectures delivered at the University of Pittsburgh. "Tax Problems in

Incorporating a Partnership or an Individual Proprietorship," contributed by Mr. Conrad, is referred to as, "A well-organized analysis of the factors that must be considered in evaluating the tax benefits of incorporation."

Philadelphia Office

Anthony J. DiIenno, of our Tax Department, has been made a Director of the Dale Carnegie Course in Public Speaking, Philadelphia.

On November 17, Mr. Mahon talked on the subject of medical expense deduction at the Eighth Annual Institute on Federal Taxation at New York University. On December 5, he spoke before the Pennsylvania Tax Institute in Philadelphia on the subject of "Developments in Taxability of Corporate Recapitalizations, Split-ups, Stock Dividends and Related Redemptions." On December 15, Mr. Mahon talked to the Susquehanna Valley Conference of the National Association of Bank Auditors and Controllers at Williamsport, Pa., on income tax problems peculiar to banks.

Mr. James E. Gelbert, of our Tax Department, spoke on the subject of "Bureau of Internal Revenue—Its Organization, Principles and Procedures" at Temple University on November 9 before the Tax Study Group of the Philadelphia Chapter of the Pennsylvania Institute of C. P. A.'s. Mr. Gelbert is Vice Chairman of this Tax Study Group. At this session, Mr. DiIenno was Chairman of the discussion on State Taxes.

Mr. Hewitt, representing the National Association of Cost Accountants, conducted the WCAU Career Forum's seminar on "Accountancy" for that station's television program on November 30 and for its radio broadcast on December 3. The Career Forum is a vocational guidance project which is being carried on in cooperation with a number of educational institutions in the Philadelphia area.

The following members of our staff have recently been elected to membership in the Pennsylvania Institute of C. P. A.'s:

H. Donald Grim
Norman E. Miller
George W. Schelle, Jr.

New York Office

Mr. Jennings is a member of the Board of Directors of the New York State Society of Certified Public Accountants. Colonel Montgomery, Messrs. Sinclair, Lenhart, Staub, Carson, Case, Rappaport, Campbell and Bell serve as chairmen or members of various committees, as do George S. Schneider, Raymond G. Ankers, Harry O. Leete, Dallas Blair-Smith, Theodore R. Pleim, Edward J. Taylor, Alexander M. Stollmeyer and George W. F. Pavelka.

Mr. R. G. Ankers was guest speaker at a banquet given on October 18, 1949 at the Hotel Farragut,

Knoxville, Tennessee by the University of Tennessee Accounting Club. The subject of the talk was "Selection of Accounting Personnel." On October 20, 1949, he spoke before the Accounting Club of Indiana University on the subject "Opportunities in Public Accounting."

Mr. Robert D. Preston, Jr. was recently elected to membership in the New Jersey Society of Certified Public Accountants.

Mr. T. R. Pleim led the discussion at the December forum of the N. A. C. A., and Mr. G. R. Byrne spoke January 5, 1950 on the subject "Internal Reports vs. Published Reports."

Mr. Herbert C. Clough, Jr. and Mr. Alan W. Drew were elected to membership in the New York State Society of Certified Public Accountants. Mr. Hewitt and Mr. Schweitzer, of our Philadelphia office, were also elected.

Rockford Office

Mr. Bernard L. Moeck was recently elected Director of Memberships in the Rockford Chapter of the N. A. C. A.

On December 13, 1949, Messrs. Robert W. Myers, and Leo Tinkham talked before a discussion forum meeting of the Rockford Chapter of the N. A. C. A. Their subject was "Corporation Income Taxes" with special emphasis on year-end tax planning.

San Francisco Office

At the invitation of Mr. Keast, Consulting Professor at Stanford University, Professor Oswald Nielsen and twenty-six graduate students came to 100 Bush Street on the afternoon of November 17. A short, stimulating talk by Mr. Keast was followed by a discussion by Mr. Giles on auditing procedures in action, a brisk question and answer session, and a tour of the office.

William Davis, Ben Hollinger and William Loomis are active members of the new Toastmasters' Club Chapter sponsored by the California Society of Certified Public Accountants.

Beginning in November, the staff has held weekly discussions on *Montgomery's Auditing*, Seventh Edition, with a staff member leading the discussion on one selected chapter at each meeting.

Seattle Office

Mr. Aiken addressed two auditing classes graduating from the School of Business Administration at the University of Washington on the subject "Verifications." He was chairman of the C. P. A. committee which arranged a joint meeting on December 6 of the Seattle Chapter of the Washington Society of Certified Public Accountants and the Seattle Bar Association.

Mr. W. R. Shapton has received his C. P. A. certificate in the State of Washington.

At the sixty-second annual meeting of the American Institute of Accountants, held in Los Angeles beginning November 1, 1949, Mr. Sinclair was elected as a Council Member at Large and Mr. Zipf as Member of the Council from Pennsylvania, each for a three-year term. The following members of the staff have been elected members of the Institute:

Charles F. Berry	San Francisco
W. J. Brinkman	Baltimore
Herbert J. Brown	New York
William G. Casey	Philadelphia
Leon Daniels	Philadelphia
Joseph C. Dise	Philadelphia
Robert E. Fish	Chicago
James D. Flaherty	Pittsburgh
William E. Greene	Chicago
H. Donald Grim	Philadelphia
James J. Hickey	New York
Ben F. Hollinger	San Francisco
Oral W. Huth	Cleveland
Wm. R. Loomis	San Francisco
Charles H. Lundquist	Los Angeles
Norman E. Miller	Philadelphia
Louis C. Moscarello	New York
Angelo Nastasi	Baltimore
Charles A. Pearson	Los Angeles
Aldrich Prech	Cleveland
Patrick B. Reynolds	Detroit
George W. Schelle, Jr.	Philadelphia
Elio A. Venanzi	Boston
Percy H. Wehr, Jr.	New York
Merle S. Wick	New York

Travel in Alaska and Saudi Arabia

(*Continued from page 11*)

The tomblike quiet in downtown Jeddah during the daylight hours of Ramadhan, and then the awakening of the town in general, with government offices, foreign banks, business houses, stores, etc., opening for business a little after sunset until past midnight.

The Sudanese boys who served as kitchen helpers, whose faces were marked with long deep scars placed there by tribal custom when they were quite young.

The return from Dhahran was made via Cairo, Athens, Rome, Zurich, Paris, Shannon (Ireland), Gander, and then the very welcome sight of New York, less than forty hours after boarding the "Connie" at Dhahran.

I was glad to have had the opportunity to make the visit to Saudi Arabia and to view at first hand the country, its people and customs, and some of the accomplishments by the Americans to make it a better place to live. The Arabs are a friendly and a dignified people and there is a fine spirit of cooperation evident in the relations between them and the Americans.

Lybrand, Ross Bros. & Montgomery

Offices

Cities	*Addresses*
Atlanta 3	Healey Building
Baltimore 2	First National Bank Building
Boston 10	80 Federal Street
Chicago 4	231 South LaSalle Street
Cincinnati 2	Carew Tower
Cleveland 15	Midland Building
Dallas 1	First National Bank Building
Detroit 26	Book Building
Houston 2	920 Milam Building
Los Angeles 13	510 South Spring Street
Louisville 2	Heyburn Building
New York 4	90 Broad Street
Philadelphia 2	Packard Building
Pittsburgh 22	Oliver Building
Rockford, Ill.	321 West State Street
San Francisco 4	100 Bush Street
Saint Louis 1	411 North Seventh Street
Seattle 1	Skinner Building
Washington 5	Investment Building

Europe

London, England	3 St. James's Square, S. W. 1
Paris 1, France	39 Rue Cambon